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**PRE-FILED TESTIMONY  
OF  
KATHLEEN A. CUMMINGS**

**BELL ATLANTIC CORPORATION  
AND  
GTE CORPORATION  
PUC990100**

**Q1. PLEASE STATE YOUR NAME AND POSITION WITH THE COMMISSION.**

**A1.** My name is Kathleen A. Cummings. I am the Deputy Director responsible for rates and costs in the Division of Communications.

**Q2. PLEASE DESCRIBE THE PURPOSE OF YOUR TESTIMONY.**

**A2.** My testimony addresses the standards the Staff considered in evaluating the proposed merger between Bell Atlantic Corporation ("Bell Atlantic") and GTE Corporation ("GTE") (collectively "the Joint Petitioners") with respect to the requirements of § 56-90 of the Code of Virginia ("Va. Code \_\_\_\_"). I will also comment on several of the proposed commitments and merger benefits that Bell Atlantic - Virginia, Inc. ("BA-VA") and GTE South Incorporated ("GTE South") ("collectively the Companies") have identified in their petition. Finally, I will present the Staff's overall position on the application based on all the Staff testimony filed in this proceeding.

**Q3. HAVE PUBLIC COMMENTS BEEN FILED IN THIS CASE?**

**A3.** Yes, the Commission has received 41 comments regarding the merger between Bell Atlantic and GTE. Approximately 33 of these were from individuals. Of these individual comments, 25 oppose the merger and 8 favor it.

**Q4. PLEASE IDENTIFY THE STANDARDS OF REVIEW THE STAFF UTILIZED IN ITS EVALUATION OF THE MERGER.**

**A4.** Prior to granting approval of a merger, Va. Code § 56-90 requires the Commission be satisfied that the merger will not impair or jeopardize adequate service to the public at just and reasonable rates. The Staff has stated in previous reviews<sup>1</sup> that a proposed merger's impact in Virginia should be evaluated in light of the Commission's method of regulation of the involved carriers (or their affiliates/subsidiaries) and with consideration to the marketplace(s) in which they operate. In addition, the evaluation of a merger should focus on the jurisdictional regulated intrastate services and rates that may be impacted. In this instance, both BA and GTE have subsidiaries in Virginia that provide various regulated and nonregulated telecommunications services, including the provision of local exchange service as incumbent local exchange carriers ("ILEC").

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<sup>1</sup>See March 23, 1998, Staff Report in Petition of MCI Communications Corporation and WorldCom, Inc. Case No.PUA970052.

**Q5. WHY IS IT NECESSARY TO LOOK AT THE REGULATION OF THE COMPANIES AND THE MARKETS IN WHICH THEY OPERATE?**

**A5.** The Commission's role in regulating telecommunications companies operating in various markets can generally provide an implicit definition of "adequate service at just and reasonable rates" under Va. Code § 56-90. This definition would certainly vary for different telecommunications carriers because regulation and their markets and/or their relevant market power vary.

**Q6. SHOULD THE COMMISSION LOOK BEYOND THE IMPACT ON RATES AND SERVICES OF THE TELEPHONE COMPANY(S) WHOSE OWNERSHIP WILL CHANGE?**

**A6.** Yes. In this case, it is only the control of GTE South which will formally change as a result of the proposed merger since GTE will be merged into Bell Atlantic. The Commission recognized in its Final Order in PUA980031 that it must consider the merger's impact on BA-VA and its provision of services to customers in Virginia. In addition, it is also possible that a merger between GTE and BA could impact services provided by other telephone companies in Virginia which are not part of the merger.

**Q7. HOW CAN A MERGER IMPACT SERVICES PROVIDED BY OTHER TELEPHONE COMPANIES?**

**A7.** To the extent the merger impacts the competitive marketplace for telecommunications services in Virginia, it can impact other carriers and their

provision of service. It can also impact other companies which may purchase various regulated services from the companies involved in the merger.

**Q8. WHAT IS THE COMMISSION'S REGULATORY ROLE IN THE VARIOUS MARKETS IN WHICH GTE SOUTH AND BA-VA OPERATE?**

**A8.** Both GTE South and BA-VA primarily provide local exchange, access, and intraLATA toll services to customers in designated service areas in Virginia. In addition, GTE South and BA-VA are required to offer services to potential competitors through resale, interconnection, and unbundled network elements. The Commission regulates the provision of most intrastate services provided by BA-VA and GTE South through their respective alternative regulation plans ("Plans") adopted in Case No. PUC930036 pursuant to Va. Code § 56-235.5. However, intrastate access charges are not addressed in these Plans for pricing purposes. In addition, the rates, terms, and conditions for resale, interconnection, and unbundled network access are governed by the Commission pursuant to the requirements of Telecommunications Act of 1996 ("the Act") and Va. Code § 56-265.4:4 C 3.

In addition, the Commission regulates other carriers which may provide services in the same markets with BA-VA and GTE South. Facilities-based intrastate interexchange carriers are governed by rules ("IXC Rules") first adopted in Case No. PUC840017. The IXC Rules include a provision to allow a carrier to set its rates competitively pursuant to Va. Code § 56-481.1.

On December 13, 1995, in Case No. PUC950018, the Commission adopted rules ("Local Rules") pursuant to Va. Code § 56-265.4:4.C. for the

certification of competitive local exchange carriers ("CLECs"). The Local Rules provide for CLECs to meet certain conditions for certification including establishing a price ceiling in which a CLEC's rates are effectively capped by the rates charged by incumbent local exchange carriers.

**Q9. WHY DID YOU MENTION THE REGULATION OF OTHER COMPANIES IN THE MARKETS IN WHICH GTE SOUTH AND BA-VA OPERATE?**

**A9.** It is important to recognize that Va. Code § 56-90 does not limit the Commission's review of a merger to the rates and services of the companies involved. To the extent the service and rates of other carriers which are offered to the public could be impacted, such should also be considered in the review of a merger. As an example, our expectations are that a CLEC operating in an ILEC's territory would generally have rates lower than the ILECs. Therefore, a merger which either potentially results in an increase in a ILEC's rates or lessens the likelihood of rate decreases for the ILEC can have an impact on a CLEC's service. Such a result does not automatically violate the standards of Va. Code § 56-90, but it does help explain why it is necessary to look at the impact on competition in the review of this merger.

**Q10. HOW DOES THE FORM OF REGULATION OF GTE SOUTH AND BA-VA PROVIDE US WITH A DEFINITION OF "ADEQUATE SERVICE TO THE PUBLIC AT JUST AND REASONABLE RATES"?**

**A10.** The Commission determined, in Case No. PUC930036, the alternative regulatory plans under which GTE South and BA-VA would be regulated. The Plans adopted for the two companies differ substantially although both were designed to meet the requirements of Va. Code § 56-235.5. It seems both reasonable and appropriate to look to these regulatory plans and Va. Code § 56-235.5 for a definition of adequate service at just and reasonable rates. Therefore, it is necessary to consider what effect, if any, the merger might have on the ability of those Plans to meet the Va. Code § 56-235.5 requirements.

**Q11. ARE YOU SAYING "JUST AND REASONABLE" RATES MEANS AFFORDABLE RATES?**

**A11.** Not necessarily. It is not that simple. To use "affordable" rates in place of the traditional rate of return view of "just and reasonable" rates, the other requirements of Va. Code § 56-235.5 B must also be considered. That Section requires that, in order to replace the ratemaking methodology set forth in § 56-235.2 of the Code of Virginia (which is the traditional just and reasonable rates statute), an alternative regulatory plan must meet certain requirements. All of these Va. Code § 56-235.5 B requirements can, therefore, be viewed as the equivalent to "just and reasonable" for the purposes of this merger review. Therefore, adequate service to the public at just and reasonable rates for BA-VA

and GTE South under Va. Code § 56-235.5 standards implies that: (1) the affordability of basic local service must be protected; (2) the assurance of quality local service must be continued; (3) there must not be unreasonable prejudice or disadvantage to any class of telephone customers or other providers of competitors; and (4) the alternative regulation of the companies be in the public interest. In fact, Va. Code § 56-235.5 D provides for the alteration, amendment, or revocation of any alternative regulatory plan that does not meet these requirements. To the extent the merger threatens any of these conditions of the alternative regulatory plans, it also puts into question whether adequate service to the public at just and reasonable rates will be impaired or jeopardized.

**Q12. HAS THE STAFF DETERMINED IF THE PLANS ADOPTED FOR BA-VA AND GTE SOUTH CURRENTLY MEET THE VA CODE § 56-235.5 STANDARDS?**

**A12.** No. That is not a requirement of this proceeding. However, we do have concerns about current circumstances and believe the merger may make things worse. Some of these current concerns are driven from consumer complaints and the deterioration of service quality as described in Mr. Wickham's testimony. In addition, the telecommunications marketplace has changed dramatically from that which existed when the Plans were adopted. The Plans did not contemplate the Telecommunications Act of 1996 nor the current wave of mega-mergers in the telecommunications industry. Furthermore, the Plans do not address current

pricing trends such as bundled or packaged basic, discretionary (noncompetitive), and/or competitive services/products.<sup>2</sup>

**Q13. IS THE STAFF SATISFIED THAT THE MERGER BETWEEN BELL ATLANTIC AND GTE WILL NOT IMPAIR OR JEOPARDIZE ADEQUATE SERVICE AT JUST AND REASONABLE RATES?**

**A13.** No. The Staff's testimony raises concerns about the potential adverse consequences of the merger and the lack of quantifiable benefits to Virginia customers to offset such consequences.

**Q14. AREN'T THERE POTENTIAL BENEFITS TO VIRGINIA CONSUMERS FROM THE PROPOSED MERGER BETWEEN GTE AND BELL ATLANTIC?**

**A14.** Yes, Joint Petitioners have offered several specific commitments which would favorably impact service and rates to their customers in Virginia. My testimony will comment on the Joint Petitioners' proposal to expand local calling areas and GTE South's offer to reduce rates in its southwest territory and its deployment of Class services. I will also briefly discuss several other items which the Joint Petitioners describe as benefits of the merger. Those include their best practices policy, network investment, and bundling of services.

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<sup>2</sup> The Joint Petitioners claim that there is a national market for bundled services. In Cases No. PUC990010 and PUC990011, the Commission recognized that the alternative regulatory plan for the Sprint companies does not address pricing categories for packaged offerings. The Commission's Order requires these companies to file proposed changes to the plan if they intend to offer Sprint Solutions beyond 1999.



**Q15. PLEASE COMMENT ON THE PROPOSED EXPANDED LOCAL CALLING PLAN.**

**A15.** The Joint Petitioners estimate that the proposed calling plan will benefit more than one million GTE South and BA-VA customers and will reduce the Companies' revenues by more than \$22 million. The Staff believes this proposed contiguous calling plan will benefit some GTE South and BA-VA customers. However, it is premature to quantify the impact on the Companies or evaluate all the potential merits as it would be necessary for any such plan to be filed, noticed to the public, and approved in accordance with Virginia Code § 56-484.3.

The Staff previously expressed several concerns with the proposed calling plan in its Report filed in Case No. PUA980031. First, we are concerned that a contiguous calling plan will not always address expansion of service for the routes with the highest community of interest for a particular exchange.

In addition, with respect to rates, if the calling plan for any exchange is approved, it may result in rate increases for individual exchanges due to rate regrouping. Some of these potential rate increases are substantial, and some consumers may be unwilling to agree to an expanded calling plan which increases rates. This is not necessarily an obstacle to the merger; however, it highlights that the quantification of the impact of the proposed calling plan cannot be determined until it has been approved by individual exchanges and implemented. This would not be completed until eighteen months after the consummation of the merger.

**Q16. WHAT ABOUT THE PROPOSAL TO REDUCE THE RATES OF GTE SOUTH IN ITS SOUTHWEST TERRITORY?**

**A16.** This is certainly a quantifiable benefit to certain GTE South customers. The proposed rate reductions would bring GTE South's local exchange rates in southwest Virginia to parity with comparably sized exchanges in the rest of GTE's territory (and comparable to BA-VA). The Joint Petitioners state this would result in an annual revenue reduction of approximately \$2 million.

**Q17. WOULD YOU COMMENT ON THE COMMITMENT TO MAKE CLASS SERVICES AVAILABLE TO ALL GTE SOUTH CUSTOMERS WITHIN EIGHTEEN TO TWENTY-FOUR MONTHS OF THE CONSUMMATION OF THE MERGER?**

**A17.** While this is potentially good news for certain GTE South customers, it is unknown how much of an improvement this is over the current deployment schedule. Right now the expected date of consummation of the merger is not known so it is difficult to determine how far in advance of the current schedule such services would be deployed. Presently, GTE South has 11 exchanges (and four other subsets of exchanges served by specific remotes) which would be impacted by this commitment. The current schedule provides that these would have Class services available by year 2004.

**Q18. WHY DO YOU SAY THE EXPECTED CONSUMMATION DATE IS UNKNOWN?**

**A18.** In response to a Staff interrogatory, the Joint Petitioners state that the expected completion date of the merger is no later than the end of the first quarter 2000. However, by letter dated April 14, 1999, BA and GTE requested the Federal Communications Commission ("FCC") not proceed with the review until they make a further submission to address long distance issues. This is to be done after Bell Atlantic files its "New York 271 application" with the FCC. The letter goes on to state that they "do not want the FCC to waste valuable time and resources on a proposal that has been overtaken by events." According to discussions with the FCC Staff, they are, therefore, not actively evaluating the BA/GTE merger petition. A copy of the Joint Petitioner's April 14, 1999, letter to the FCC is attached as Exhibit 1 and the response to the Staff's interrogatory is Exhibit 2.

**Q19. THE JOINT PETITIONERS CLAIM THAT ONE OF THE BENEFITS OF THE MERGER IS THE IDENTIFICATION AND ADOPTION OF BEST PRACTICES. DO YOU AGREE?**

**A19.** I'm unable to give a definitive answer. The intent of combining the best practices of the Joint Petitioners to achieve savings and other operational benefits and efficiencies is certainly a laudable goal when two companies merge. The Joint Petitioners Witness Lenz describes the general criteria to be used in the selection of best practices. However, the Joint Petitioners have only provided three examples of best practices "opportunities" for Virginia. They have not provided

sufficient support or documentation that best practices will result in improving the "quality and efficiency of the service they provide," as the petition claims.

Without identification of best practices and an implementation plan, the Staff is unable to determine whether the potential impact of a best practice will or will not impair or jeopardize the provision of regulated services in Virginia. The Staff can certainly envision the corporate-wide implementation of "best practices," as defined by the Joint Petitioners,<sup>3</sup> which could enhance shareholder value (or even another state's service) but could either not enhance or actually harm the provision of service in Virginia.

We recognize that it is difficult to provide very detailed information at this point. However, that does not overcome the need to evaluate this if the Joint Petitioner's claim that adopting best practices will enhance service. The Staff suggests that if the merger is approved, the Petitioners should be required to file an annual report detailing the best practices adopted. This report should include an impact statement for Virginia and should be required to be filed for a reasonable period of time (i.e. three to five years).

**Q20. PLEASE COMMENT ON THE COMMITMENTS TO INVEST IN THEIR NETWORKS IN VIRGINIA.**

**A20.** The Joint Petitioners state that they will "invest in Virginia at the same average annual rate over the three years following the merger (2000-2002) as they did the three years prior to the merger (1996-1998)."<sup>4</sup> The Joint Petitioners claim that

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<sup>3</sup> Best practices generally refers to the "most effective strategies, policies, processes and procedures in a particular industry." See witness Lenz's testimony at p.1.

<sup>4</sup> BA-VA witness Stallard pg. 25.

this commitment is "concrete insurance" that the merger will not jeopardize service by diminishing investment in Virginia.

The Staff is unable to evaluate this claim fully as the Joint Petitioners have been unable to provide any details of planned capital investment they will undertake in Virginia over the 2000-2002 period. In response to a Staff interrogatory requesting information on specific construction projects, both Joint Petitioners state that such information is unavailable at this time. Further, in response to a Staff interrogatory, the Joint Petitioners forecasted continued significant line growth over the 2000 to 2002 time period. Therefore, particularly in light of the current service quality issues raised in Mr. Wickham's testimony, we believe it would seem reasonable to expect, without additional details, that future investment would need to **increase** rather than remain the same.

**Q21. THE JOINT PETITIONERS CLAIM THAT VIRGINIA WILL BENEFIT BECAUSE THE MERGER ENHANCES THE COMBINED COMPANY'S ABILITY TO OFFER BUNDLED AND PACKAGED SERVICES. WOULD YOU PLEASE COMMENT ON THIS CLAIM?**

**A21.** The Joint Petitioners claim that the merger will ultimately allow the "combined company" to offer a full slate of communications services on a national and international basis.<sup>5</sup> According to the Joint Petitioners, consumers will benefit because the "combined company" will be able to offer these bundled services in Virginia. The Staff believes this "benefit" should be given little if any consideration by the Commission. The Joint Petitioners do not need to merge in

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<sup>5</sup> Bell Atlantic witness Stallard at 32-34 and GTE witness Zimmerman at 4-7.

order to offer bundled or packaged services. In fact, the merger actually further limits GTE's ability to offer packages of services, in particular interLATA long distance, since it will be unable to provide such until Bell Atlantic receives Section 271 authority under the Act for Virginia.<sup>6</sup>

Furthermore, many of the "potential" bundled or packaged services/products identified by the Joint Petitioners are not jurisdictionally intrastate or regulated by this Commission (i.e. Internet, interstate/international toll, and wireless). In addition, the Staff believes it is unlikely that BA-VA and/or GTE South would be the entities offering the national bundled services to consumers on behalf of the new combined company in Virginia.

**Q22. DOES THE STAFF HAVE ANY CONCERNS ABOUT GTE SOUTH'S CONTINUED PROVISION OF ITS INTERLATA LOCAL CALLING PLAN ROUTES?**

**A22.** No. The Joint Petitioners included a copy of their filed request to the FCC to continue providing the GTE South interLATA Local Calling Plan ("LCP") routes. The Joint Petitioners' petition, at page 4, states that "the merger will not be consummated unless these services can continue to be provided after the merger." The Staff may have some reservations about whether the FCC will approve the continuation of the interLATA LCP routes; however, the Joint Petitioners

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<sup>6</sup> The proposed tariff included in GTECC's application for local exchange authority in Case No. PUC980080 provided for bundled local and intrastate/interstate toll.

commitment would prevent the immediate impairment to GTE South's rates and services if the interLATA LCP routes had to be otherwise discontinued as a result of the merger.

**Q23. PLEASE COMMENT ON THE PROVISION OF GTE COMMUNICATION CORPORATION'S PROVISION OF INTERLATA SERVICES IF THE MERGER IS COMPLETED.**

**A23.** The Joint Petitioners have not filed a request with the FCC on behalf of GTE Communications Corporation ("GTECC") to permit the continuation of interLATA long distance service to customers in Virginia. The Joint Petitioners state that GTECC would not be permitted to continue providing interLATA service in Virginia following the merger without Bell Atlantic obtaining § 271 authority from the FCC.

The Staff does not view discontinuation of GTECC service in Virginia as an impairment of service under Va. Code § 56-90. First, the Commission does not regulate GTECC as it operates as a long distance reseller in Virginia. In addition, GTE has agreed to provide adequate time for existing customers to choose another interLATA carrier if it must discontinue service.

**Q24. MS. SEDGLEY HAS DETERMINED THAT THE MERGER WOULD HAVE A NEGATIVE IMPACT ON LOCAL EXCHANGE COMPETITION IN VIRGINIA. DOES THAT MEAN THE MERGER CANNOT BE APPROVED IN VIRGINIA?**

**A24.** No. To the extent the anti-competitive nature of the merger in Virginia can be balanced or offset by benefits or additional commitments, the merger could be approved. However, it is the Staff's position that as currently presented by the Joint Petitioners the merger benefits and/or commitments do not fully accomplish this.

**Q25. DOES THE STAFF BELIEVE THAT THERE ARE WAYS TO COUNTER THE ANTI-COMPETITIVE IMPACT OF THE MERGER?**

**A25.** Yes. Ms. Sedgley discusses the anti-competitive concerns of the merger with respect to the Companies' Plans. However, as she also notes, this would not necessarily "foster" local competition. Therefore, additional measures may be necessary. One way to do this is for the Commission to consider requiring additional market opening conditions. The public testimony of several CLECs at the March 1999 hearing in PUA980031 focused on the problems they were facing in obtaining service from BA-VA and GTE South in Virginia. The Staff is also aware of a number of other formal and informal complaints by CLECs in Virginia which claim that they are unable to obtain reasonable, adequate and timely services from the Companies.



**Q26. IS THE STAFF STATING THAT THE TELECOMMUNICATIONS ACT OF 1996 AND THIS COMMISSION'S ACTIONS TO DATE HAVE FAILED TO OPEN THE LOCAL MARKET TO COMPETITION?**

**A26.** No. However, despite the efforts by all parties, ILECs, CLECs, the FCC, and this Commission, there is still a lot to be done to ensure the local exchange market is truly open and competitive in Virginia. As Ms. Sedgley notes in her testimony, BA-VA and GTE South still retain at least 98% market share in their respective service territory.

**Q27. DON'T THE REQUIREMENTS OF THE ACT, INCLUDING § 271 AUTHORITY, PROVIDE SUFFICIENT MARKET OPENING CONDITIONS?**

**A27.** Not necessarily, with respect to approval of the merger between Bell Atlantic and GTE. To the extent the merger thwarts or delays local competition in the service territories of BA-VA and GTE South, the Commission can and should consider additional requirements that will assist the efforts to implement a competitive marketplace in Virginia. In addition, GTE is not now subject to § 271 of the Act since it is not a Bell operating company; and after the merger, as an affiliate, it would not have to "prove" it has met the § 271 (c)(2)(B) "competitive checklist" requirements for Virginia to either the FCC or this Commission as BA-VA must do.

**Q28. DOES THE STAFF HAVE A SPECIFIC LIST OR SET OF MARKET OPENING CONDITIONS IT WOULD RECOMMEND?**

**A28.** No, establishing a comprehensive set of such market opening requirements involves very complex issues as well as substantial knowledge of both BA and GTE's practices, procedures, and operating systems. The intervenors in this case have identified a number of such potential conditions. However, the Staff agrees with the other parties that testing and improvements in Operation Support Systems ("OSS") and adoption of performance standards are two very critical areas.

Other conditions such as implementing UNE pricing for GTE South using the costing methodology adopted for BA-VA in Case No. PUC970005 and adopting the "most favored" terms between the Companies' interconnection agreements merit serious consideration as well.

The Staff also suggests that the Joint Petitioners be required to prioritize the evaluation of "best practices" with respect to dealing with CLECs. This should include the consideration of consolidation of various interfaces, processes, operating systems, as well as adopting consistent company-wide practices and policies. We believe local competition could be fostered by giving CLECs the ability to interface with one company after the merger, rather than two.

**Q29. IF THE COMMISSION DETERMINES MARKET OPENING CONDITIONS ARE NECESSARY, HOW SHOULD THOSE BE DETERMINED?**

**A29.** The Staff has several suggestions for the Commission's consideration. First, the Commission could wait until more activity is occurring at the federal level as it is highly likely the FCC will require certain market opening conditions in its review of the Joint Petitioners merger as it has done in similar cases.<sup>7</sup> The Commission could also establish a set of general market opening conditions or principles based on the testimony in this proceeding. The Joint Petitioners could then submit a specific proposal based on those principles including a detailed implementation schedule for further Commission review and approval. The formation of an industry task force, including representatives from the Companies and CLECs, could also be established to develop a proposal to submit to the Commission.

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<sup>7</sup> As an example, SBC Communication Inc. and Ameritech Corporation have recently submitted to the FCC a set of proposed conditions consisting of over 150 pages in the Matter of Applications for Transfer of Control of Licenses and Section 214 Authorization from Ameritech Corporation, Transferor to SBC Communications, Inc. Transferee, CC Docket No. 98-141 (August 1998).

**Q30. YOU MENTIONED THE FCC MAY REQUIRE MARKET OPENING CONDITIONS ON THE MERGER. DOESN'T THAT RAISE CONCERNS THAT CONDITIONS REQUIRED FOR APPROVAL OF THE MERGER BY THE FCC COULD IMPACT VIRGINIA?**

**A30.** Yes. The Commission should be aware that subsequent FCC action could impact the details of the merger as presently represented by the Joint Petitioners to this Commission. The Staff believes the Joint Petitioners should not be permitted to consummate the merger unless the Commission is convinced that any conditions or requirements placed on the merger by the FCC would not impair or jeopardize rates or service provided by BA-VA and GTE South in Virginia.

**Q31. THE STAFF HAS EXPRESSED OTHER CONCERNS ABOUT THE MERGER SUCH AS THE CONTINUED ASSURANCE OF SERVICE QUALITY AND POTENTIAL FOR CROSS SUBSIDIZATION. HOW SHOULD THESE CONCERNS BE BALANCED?**

**A31.** The Staff does not believe that just the continued ability of this Commission to regulate BA-VA and GTE South provides sufficient assurance that rates and/or service will not be impaired or jeopardized. The ability to "correct" a potential deficiency **after** it occurs does not avoid an impairment, however temporary. As other Staff members have pointed out, there is a need to reexamine the current alternative regulatory plans. It is the Staff's position that such an examination can incorporate various safeguards and/or penalties to deal with many of the potential negative consequences of the merger between Bell Atlantic and GTE.

**Q32. PLEASE SUMMARIZE THE STAFF'S POSITION ON THE MERGER.**

**A32.** We are not satisfied that the Joint Petitioners' petition and testimony meet the requirements for approval under Va. Code § 56-90. However, the Staff believes the Commission can offset or balance the Staff's major concerns by requiring additional market opening conditions and a re-evaluation of the current regulatory plans of BA-VA and GTE South.

Further, if the merger is ultimately approved, the Joint Petitioners should be required to file an annual best practices report and track their actual merger costs and savings as recommended in Ms. Gilmour's testimony. In addition, the Companies should be required to file for prior approval for various affiliate agreements as described in Mr. Dalton's testimony.

**Q33. DOES THIS CONCLUDE YOUR TESTIMONY?**

**A33.** Yes.

**PRE-FILED TESTIMONY  
OF  
ALAN R. WICKHAM**

**BELL ATLANTIC CORPORATION  
AND  
GTE CORPORATION  
PUC990100**

**Q1. PLEASE STATE YOUR NAME AND POSITION YOU HOLD WITH THE VIRGINIA STATE CORPORATION COMMISSION.**

**A1.** My name is Alan R. Wickham and I am the Deputy Director responsible for operations in the Division of Communications.

**Q2. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

**A2.** My testimony will cover three issues that must be considered in the proposed merger of Bell Atlantic Corporation ("BA") and GTE Corporation ("GTE"). The three issues are: 1) concerns about the service currently being provided by the Virginia subsidiaries of these two corporations, 2) maintenance of outside plant, especially in more rural areas, and 3) service quality safeguards if the merger is approved.

**Q3. WHAT ARE THE CONCERNS WITH REGARD TO SERVICE?**

**A3.** Bell Atlantic-Virginia has not consistently met the Commission's service standards for business office and repair center accessibility, that is, the percent of calls answered within twenty seconds. Since 1995, BA-VA's business office accessibility has been less than satisfactory nine out of seventeen reported quarters, and repair center accessibility has been less than satisfactory eight out of

seventeen quarters (January 1995 through 1st quarter 1999). Also, BA-VA reported less than satisfactory results for service orders completed within five working days for the last seven reported quarters (3rd quarter '97 through 1st quarter '99). This is primarily the result of understaffing and, in some cases, high turnover of employees. It can take months of training and experience before a new employee becomes proficient.

The area of greatest concern, however, is the upward trend in customer complaints to the Commission. These trends are shown for both BA-VA and GTE South on attachments marked ARW1 through ARW6. Customers are complaining primarily about service outages over twenty-four hours, missed repair commitments and seemingly uncaring and rude telephone company employees. I have personally read many of the letters written to the Commission by angry and very frustrated customers. Many are two or more pages of well documented experiences with BA-VA's and GTE South's service.

**Q4. DO YOU THINK THAT A MERGER OF BA AND GTE WOULD HAVE ANY IMPACT ON THE PRESENT LEVELS OF SERVICE BEING PROVIDED BY THE COMPANIES?**

**A4.** It's hard to say. When GTE and Contel Corporation ("Contel") merged in the early '90s, there was a significant, to put it mildly, deterioration in service quality. The Commission opened a formal service investigation to address the numerous problems that customers were experiencing. In that instance, GTE and Contel attempted unsuccessfully to consolidate the companies' operations. It took months to correct all of the problems that were the direct result of that merger.

BA-VA and GTE South claim that there are no immediate plans to merge their operations, i.e., the companies will operate as separate subsidiaries within the same corporation. That being the case, the service rendered by the two companies may not be affected. The problem, of course, is that service quality is already impaired, especially that of BA-VA, and needs to be fixed before these companies merge. Our Staff is actively working with BA-VA to get these problems corrected.

**Q5. PLEASE EXPLAIN THE CONCERNS REGARDING PLANT MAINTENANCE.**

**A5.** BA and GTE claim that they will invest in their networks at the same average amount during the period 2000 through 2002 as they invested during the previous three years to the proposed merger. Based on the high level of customer trouble reports, especially in rural areas, and the poor plant conditions observed by our Staff, investments during the previous three years appear to be inadequate. In response to a Staff interrogatory, BA and GTE also state that they are unable to provide a projected budget for maintenance of outside plant for the period 2000 through 2002. More capital investment must be directed toward maintaining plain old telephone service for all customers while continuing to invest in and deploying new services for customers who desire, for example, high-speed Internet access.

**Q6. WHAT SAFEGUARDS WOULD YOU RECOMMEND IF THE MERGER IS APPROVED?**



**A6.** The Commission should require further assurances from BA-VA and GTE South that the merger will not adversely impact service quality. Indeed, both companies need to provide more details on how service will be enhanced by the merger. Customers deserve no less.

Consideration should be given to penalties if service suffers as a result of the merger. Such penalties could be imposed pursuant to applicable sections of the Code of Virginia. If the Commission re-evaluates the BA-VA and GTE South regulatory plans, penalties for inadequate service should be incorporated into any new regulatory plan(s). For example, BA-VA's current plan allows rate increases for discretionary services, and after January 1, 2001, also for basic services, without regard to its level of service quality. A company should not be allowed to increase rates if it is not providing satisfactory service.

**Q7. DOES THIS CONCLUDE YOUR TESTIMONY?**

**A7.** Yes.

**PRE-FILED TESTIMONY  
OF  
ROBERT C. DALTON**

**BELL ATLANTIC CORPORATION  
AND  
GTE CORPORATION  
PUC990100**

**Q1. WHAT IS YOUR NAME AND POSITION YOU HOLD WITH THE  
STATE CORPORATION COMMISSION?**

**A1.** My name is Robert C. Dalton, and I am a Principal Public Utility Accountant in the Commission's Division of Public Utility Accounting in charge of applications involving affiliate transactions and utility assets/securities transfers and transfers of control.

**Q2. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

**A2.** The purpose of my testimony is to discuss the representations made by Bell Atlantic Corporation ("Bell Atlantic") and GTE Corporation ("GTE"), (collectively referred to as "the Petitioners") as to the anticipated economic impact the proposed merger will have on the Commonwealth of Virginia and to address issues related to affiliate transactions.

**Q3. HAVE THE PETITIONERS ADDRESSED THE ANTICIPATED  
ECONOMIC IMPACTS OF THE MERGER IN VIRGINIA, SUCH AS  
EMPLOYEE LEVELS?**

**A3.** Yes, the Petitioners indicate that the proposed merger is not expected to have a material impact on employment levels of Bell Atlantic Associates or GTE hourly

employees. They also indicate that all existing union contracts will be honored. The Petitioners indicate that, in the longer term, it is anticipated that the merger will generate more job opportunities in Virginia. The Petitioners represent that the Communications Workers of America support the merger.

**Q4. IF THE MERGER IS APPROVED AND CONSUMMATED, WILL BELL ATLANTIC-VIRGINIA, INC. (“BA-VA”) AND GTE SOUTH INCORPORATED (“GTE SOUTH”) BE CONSIDERED AFFILIATES PURSUANT TO CHAPTER 4 OF TITLE 56 OF THE CODE OF VIRGINIA?**

**A4.** Yes, they will be considered affiliates as defined in Chapter 4 of Title 56 of the Code of Virginia. However, the two Companies are currently subject to different requirements as to filing for prior approval of contracts and arrangements with affiliates.

**Q5. HOW ARE THEY DIFFERENT?**

**A5.** BA-VA was granted an exemption from obtaining prior approval under Chapter 4, and GTE South was granted a limited exemption from obtaining prior approval under Chapter 4.

**Q6. WHAT REQUIREMENTS CURRENTLY APPLY TO BELL ATLANTIC-VA FOR FILING FOR PRIOR APPROVAL OF TRANSACTIONS WITH AFFILIATES?**

**A6.** By Commission Final Order dated March 28, 1997, in Case No. PUA960044, Bell Atlantic-VA was granted an exemption from filing for prior approval of

agreements with affiliates. Rather than being required to file for prior approval of agreements with affiliates, BA-VA was required to file notices of any new agreements and revisions to existing agreements amounting to more than \$250,000 for a two-year period from March 28, 1997. BA-VA is also required to file an Annual Report of Affiliate Transactions (“Annual Report”) with the Director of Public Utility Accounting of the Commission. Such Annual Report must be filed by no later than April 1 of each year. Because the two (2)-year period has expired, BA-VA is no longer required to file any notices. The only filing required of BA-VA under Chapter 4 is to file an Annual Report of Affiliate Transactions.

**Q7. WHAT INFORMATION IS REQUIRED IN THE ANNUAL REPORT?**

**A7.** Pursuant to the Commission’s Final Order in Case No. PUA960044, BA-VA is required to identify all transactions entered into with any of its affiliates.

**Q.8. WHAT REQUIREMENTS CURRENTLY APPLY TO GTE SOUTH FOR FILING FOR PRIOR APPROVAL OF TRANSACTIONS WITH AFFILIATES?**

**A8.** By Commission Order Granting Limited Exemption dated May 8, 1998, in Case No. PUA970043, GTE South was granted a limited exemption from obtaining prior approval for contracts or arrangements which have total gross annual billings of up to \$3 million on a GTE South basis and have an impact on a Virginia jurisdictional basis of \$250,000 or less. However, contracts or arrangements which have a jurisdictional impact of more than \$250,000 during a

calendar year require prior approval regardless of the total contract or GTE South amount. Contracts with total gross annual billings of over \$3 million require prior approval regardless of the anticipated Virginia jurisdictional impact. All contracts and arrangements with affiliates are required to be included in an Annual Report to be filed with the Director of Public Utility Accounting of the Commission by no later than May 1 of each year.

**Q9. DID THE COMMISSION'S MAY 8, 1998, ORDER PLACE ANY OTHER REQUIREMENTS ON GTE SOUTH REGARDING CHAPTER 4?**

**A9.** Yes, there were several other requirements placed on GTE South. GTE South was ordered to use care in determining whether its agreements with its affiliates are likely to reach the thresholds set forth in the Order to ensure that applications are filed in a timely manner when prior approval is required. Such applications are to be filed in advance of the total annual billings reaching the threshold amounts set forth in the Order, rather than after the fact. GTE South was also ordered to follow the pricing policy as outlined in Case No. PUC950019 and to file copies with the Director of Public Utility Accounting, within forty-five (45) days of execution, of all contracts or arrangements entered into. All contracts or arrangements must be filed regardless of the amount. In its Order, the Commission stated that agreements above the threshold amount must not be separated to avoid pre-approval requirements.

**Q10. WHAT IS THE PRICING POLICY REFERRED TO ABOVE?**

**A10.** Where services are provided by GTE South to an unregulated affiliate, pricing should be at the higher of cost or market. Where services are provided to GTE South from an unregulated affiliate, pricing should be at the lower of cost or market. Services provided to and from GTE South and a regulated affiliate should be at cost. Services provided to or from GTE South pursuant to a tariff should be at the tariff rate.

**Q11. WHAT INFORMATION IS TO BE INCLUDED IN GTE SOUTH'S ANNUAL REPORT?**

**A11.** Information to be included in the Annual Report includes identification of the contracts or arrangements entered into and for each contract or arrangement, specifically, the component costs where services are provided to an affiliate, profit component, comparable market value, percentage charged to expense or capital accounts, and allocation bases used.

**Q12. SHOULD BA-VA AND GTE SOUTH CONTINUE TO BE SUBJECT TO THEIR CURRENT REQUIREMENTS UNDER CHAPTER 4 OF TITLE 56 AFTER THE MERGER, IF SUCH MERGER IS APPROVED?**

**A12.** Yes, BA-VA and GTE South should continue with the same requirements (exemptions) for obtaining prior approval for contracts and arrangements with Bell Atlantic affiliates for BA-VA and GTE affiliates for GTE South as long as each company continues under its respective existing regulatory plans. Whether or not the merger is approved, if the Commission changes the regulatory plans for

BA-VA and GTE South, the current exemptions should be reviewed and re-evaluated.

**Q13. IF THE MERGER IS APPROVED, WHAT PRIOR APPROVAL FILING REQUIREMENTS SHOULD BA-VA AND GTE SOUTH BE SUBJECT TO AFTER THE MERGER?**

**A13.** BA-VA and GTE South should be required to file for prior approval of all contracts and arrangements between each other. BA-VA should also be required to file for prior approval of any contracts or arrangements between BA-VA and any GTE affiliates. GTE South should also be required to file for prior approval of any contracts or arrangements between GTE South and Bell Atlantic affiliates.

**Q14. WHY SHOULD BA-VA AND GTE SOUTH NOT BE ALLOWED THE CURRENT EXEMPTIONS REGARDING FILING FOR PRIOR APPROVAL WHEN ENTERING INTO ARRANGEMENTS WITH AFFILIATES OF EACH OTHER?**

**A14.** Because the two companies, BA-VA and GTE South, are currently operating under different regulatory plans, there is a need to review and monitor all affiliate transactions among these entities to ensure that costs of one are not inappropriately shifted to the other. Without reviewing and monitoring all affiliate transactions between BA-VA and GTE South, there is the incentive for costs being shifted from Bell Atlantic companies to GTE South to reduce possible refunds to customers.

**Q15. DOES THIS CONCLUDE YOUR TESTIMONY?**

**A15.** Yes, it does.



**PRE-FILED TESTIMONY  
OF  
AMY J. GILMOUR  
  
BELL ATLANTIC CORPORATION  
AND  
GTE CORPORATION  
CASE NO. PUC990100**

**Q1. PLEASE STATE YOUR NAME AND POSITION YOU HOLD WITH THE VIRGINIA STATE CORPORATION COMMISSION.**

**A1.** My name is Amy J. Gilmour and I am a Principal Public Utility Accountant with the Commission's Division of Public Utility Accounting.

**Q2. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

**A2.** My prefiled testimony will cover two issues concerning the plan of merger between Bell Atlantic Corporation ("Bell Atlantic") and GTE Corporation ("GTE") (collectively "Joint Petitioners"). The first issue concerns how the merger will affect the current alternative regulatory plans of Bell Atlantic – Virginia, Inc., ("BA-VA") and GTE South Incorporated ("GTE South"). The second issue I will address is the estimate of costs and savings arising from the merger and the jurisdictional amounts projected for BA-VA and GTE South.

**Q3. PLEASE BEGIN YOUR DISCUSSION OF THE CURRENT ALTERNATIVE REGULATORY PLANS FOR BA-VA AND GTE SOUTH.**

**A3.** The statute governing merger applications states that approval may be given by the Commission if it is satisfied that the merger will not impair adequate service at just and reasonable rates, Section 56-90 of the Code of Virginia ("Va. Code § \_\_\_\_"). The alternative regulatory plans of BA-VA and GTE South were approved in Case No. PUC930036 on October 18, 1994, pursuant to Va. Code § 56-235.5. This code section allowed the Commission to "tailor regulation as needed to

respond to competition and change in the Virginia telecommunications industry.”<sup>8</sup>

Section 56-235.5 of the Code of Virginia states that any alternative form of regulation may be approved if it protects the affordability of local exchange telephone service, reasonably ensures the continuation of quality local exchange telephone service, does not disadvantage any class of telephone customers or other providers of competitive services, and is in the public interest. The Commission may also alter, amend, or revoke any alternative regulatory plans if it finds that the plan is not meeting any of the criteria stated above or if the company has violated any terms of its alternative regulatory plan (Va. Code § 56-235.5 D).

**Q4. PLEASE BRIEFLY DESCRIBE THE CURRENT ALTERNATIVE REGULATORY PLANS OF BA-VA AND GTE SOUTH.**

**A4.** BA-VA’s current alternative regulatory plan does not require an earnings review. Rather, it specifies that BA-VA’s rates will be capped for certain periods of time, depending on the classification of the service as either Competitive (no cap), Discretionary (a limited cap until January 1, 1997), or Basic (until January 1, 2001). Upon expiration of the caps, BA-VA can increase the rates per the applicable price index. Other pricing rules, such as individual-case-basis pricing, and competitive safeguards, such as unbundling of monopoly components of a competitive service, were included in the plan. Requirements for monitoring service quality were also included.

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<sup>8</sup> Commonwealth of Virginia at the relation of the State Corporation Commission Ex Parte: In the Matter of investigating telephone regulatory methods pursuant to Virginia Code § 56-235.5, etc., Case No. PUC930036, 1994 S.C.C. Ann. Rept., 262.

GTE South's current alternative regulatory plan requires an earnings review based on an Annual Informational Filing ("AIF"). The AIF is based on an allocation of the per books cost of service to GTE South's intrastate tariffed earnings. If the earnings exceed a specified range, calculated annually, GTE South must refund earnings above the top of the range to its customers. Other pricing rules and competitive safeguards have been included in the plan along with requirements for monitoring service quality.

**Q5. DOES STAFF BELIEVE THAT THE ALTERNATIVE REGULATORY PLANS OF BA-VA AND GTE SOUTH WILL ACCOMMODATE THE MERGER OF BA AND GTE?**

**A5.** Staff believes that, if the merger is approved, the alternative regulatory plans of BA-VA and GTE South should be reviewed to assure continued compliance with Va. Code § 56-235.5. First, the plans were entered into without consideration or contemplation of these two companies merging on any level. The Commission considered numerous factors when approving the current regulatory plans, including service quality, affordability of rates, competition, and public interest. Clearly the merger has a potential to affect all of these factors. As discussed by Staff witness Wickham, the merger has the potential of degrading the quality of service. Going into its current alternative regulatory plan BA-VA reduced basic rates by eliminating the charge for Touch Tone service. According to the Commission's Final Order in PUC930036, eliminating the Touch Tone rate provided further assurance that the rates going into the alternative regulatory plan were affordable. (Order at page 7.) GTE South did not make a rate reduction at

that time. Neither the merger net savings, nor the going forward level of savings after all merger costs have been completed, were contemplated when the current plans were created. The merger's impact on the cost of service and quality of service could violate the public interest standard contained in Va. Code § 56-235.5.

Second, while the Joint Petitioners state that both Virginia operating entities will continue to operate independently, they also contemplate merger cost reductions that result from operational integration. This will have an effect on the affiliate arrangements. Differences in the current form of regulation provided BA-VA and GTE South may lead to cost shifting between the two entities, which has the potential to harm telephone customers. The shifting of costs could occur even with an approved affiliate arrangement, because Staff would do a per books review of only one side of the affiliate transactions, GTE South's, under the current alternative regulatory plans. For example, if a corporate entity allocated costs to both BA-VA and GTE South and an improper allocation occurred, then GTE South may end up with more costs on its books than appropriate. Staff may not become aware of this problem because it would not be looking at BA-VA's share of the allocation under the current regulatory plans. Therefore, GTE South may report excessive costs resulting in lower earnings and not have to make a refund when in reality it should. Also, based on the current plan of GTE South, even if Staff were aware of an allocation problem, it may be precluded from correcting the problem because GTE South's plan calls for a per books analysis with only limited adjustments allowed. Currently, in Case No. PUC960134,

Application of GTE South Incorporated (Contel Virginia), Annual Informational Filing, GTE South is arguing against three Staff adjustments, one concerning an incorrect allocation from its immediate parent, GTE South Incorporated, stating that Staff's adjustments should be disallowed because they change the books of GTE South.<sup>9</sup> If Staff's adjustments are disallowed, the refund for over earnings could be lowered or removed entirely. This example highlights the fact that Staff has problems with GTE South's plan currently, and a merger between Bell Atlantic and GTE has the potential to increase this problem.

Another example of where the earnings of GTE South may be underreported occurs in the structure of the merger agreement itself. At the corporate level, GTE will incur \$56.0 million more than BA in transaction costs.<sup>10</sup> After the transaction costs are allocated to GTE South, it will see its costs increase, which could do away with potential refunds that may occur without the merger.

**Q6. PLEASE PROVIDE AN OVERVIEW OF THE ESTIMATED COSTS AND SAVINGS INCLUDED IN BELL ATLANTIC'S AND GTE'S MERGER APPLICATION.**

**A6.** Included in the filed merger application is the joint testimony of Shuell/Hall/Shore that provides a description of the process used to estimate the merger costs and savings on a corporate level down to a Virginia jurisdictional

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<sup>9</sup> Response of GTE South Incorporated to Staff's Report dated June 11, 1999, in Case No. PUC960134, at pages 1 – 3.

<sup>10</sup> Joint Petition of Bell Atlantic Corporation and GTE Corporation, For approval of agreement and plan of merger, PUC990100, Paul R. Shuell, Edwin F. Hall, and Stephen L. Shore ("Shuell/Hall/Shore"), Schedule A.2: "Estimate of Bell Atlantic Transaction Costs" and "Estimate of GTE Transaction Costs".

level. The process began with an allocation of the corporate estimate of costs/savings between Bell Atlantic and GTE. Next, different allocators were used by Bell Atlantic and GTE to further allocate the costs to a Virginia jurisdictional level. Finally, the jurisdictional amounts were allocated to an intrastate, regulated level. The final analysis, according to the Joint Petitioners, showed that at the end of the third year following consummation of the merger BA-VA and GTE South would have intrastate, regulated net savings of \$36.8 million and \$6.3 million, respectively.<sup>11</sup> The analysis also showed that after the third year the Joint Petitioners will have annual intrastate, regulated savings, going forward indefinitely of \$41.6 million for BA-VA and \$7.1 million for GTE South. All merger costs are expected to be incurred by the end of the third year following completion of the merger at the parent company level. Under the current alternative regulatory plans, BA-VA would keep all of the \$41.6 million each year; it has no obligation to reduce its rates or refund excess earnings.

**Q7. HAS STAFF CALCULATED AN ESTIMATED LEVEL OF COSTS AND SAVINGS?**

**A7.** Staff relied on the Joint Petitioners' estimate of merger costs and savings. While Staff does not have a better estimate of the actual cost/savings that will accrue to Virginia, it would point out that, if Staff were able to do an analysis such as the Joint Petitioners did, its numbers would most likely differ from the Joint Petitioners. Their estimate of merger implementation costs was based on a range

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<sup>11</sup> Shuell/Hall/Shore Schedule B.5: "Bell Atlantic-Virginia Net Merger Savings By Year" and Schedule C.5: "GTE South-Virginia Net Merger Savings By Year". These schedules also show the projected savings and costs for the first three years following the merger's completion.

with the final projection of implementation costs being based on the mid-point of that range. This obviously means that the projected merger net savings could be higher or lower depending on where in the range the implementation costs are set, assuming that the range itself is reasonable. Another example of a potential difference concerns the projected savings. Certain corporate expense savings, e.g. product advertising, were kept low due to the lack of geographic overlap between BA and GTE. In Virginia, however, where the Joint Petitioners have more contiguous area, Staff believes that a higher level of the total savings should accrue. The Joint Petitioners did not project any greater savings for these areas than other expense categories.<sup>12</sup> If Staff were to make this change to the Joint Petitioners' estimate, the merger savings would be greater in Virginia than that estimated by the Joint Petitioners. As discussed later in my testimony, these concerns are more reasons why BA-VA and GTE South should be required to track actual costs and savings from the merger.

**Q8. HAVE BA AND GTE STATED HOW ANY OF THE JURISDICTIONAL NET SAVINGS WILL BENEFIT VIRGINIA CUSTOMERS?**

**A8.** According to the Joint Petitioners at page 6 of the joint petition, the customers will see a benefit arising from the jurisdictional net savings through several commitments detailed in the merger application. The commitments that reduce revenues are i) expand local calling areas in both BA-VA's and GTE South's service territories and ii) reduction of the local exchange rates for GTE South's customers in its southwest Virginia territory. Another commitment made by BA-

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<sup>12</sup> Response to Staff's First Set of Interrogatories, No. 6.

VA is to extend the price cap on certain rates from January 1, 2001, until January 1, 2004, per its alternative regulatory plan. This commitment does not have a revenue impact although BA-VA will not be able to raise rates during that time period to cover merger costs. On the other hand, under its plan, BA-VA cannot be required to reduce rates either.

**Q9. DO YOU HAVE ANY COMMENTS CONCERNING THESE COMMITMENTS AND THEIR ASSOCIATION WITH THE PROJECTED NET SAVINGS FOR BA-VA AND GTE SOUTH?**

**A9.** Yes. Attachment 1 to my testimony is an exhibit showing the level of merger savings projected for BA-VA and GTE South and the current commitments that are projected to reduce revenues. The bottom line indicates that the projected revenue losses exceed savings for the fourth year and beyond following the merger's completion for GTE South, thus benefiting GTE South's customers, while BA-VA's customers will benefit from less than 20% of the savings projected for BA-VA. While Staff believes that the commitments have some merits, they fall short of ensuring that service quality or just and reasonable rates will not be impaired by the merger. Other Staff witnesses will discuss the merits of these commitments in their testimonies. Staff witness Cummings will address the proposed calling plan and the reduction in GTE South's southwest territory rates. Staff witness Sedgley and I address the proposed extension of the rate cap.

Concerning the proposed extension of BA-VA's cap on basic rates, Staff, in the previous BA/GTE merger case, PUA980031, recommended an eight-year price cap to help alleviate some of the anti-competitive concerns associated with



the merger. Staff continues to believe that a three-year rate cap is insufficient. Also, this commitment does not truly involve the flow-through of net savings from the merger because no rates will be lowered for BA-VA. According to the Joint Petitioners' proposal, in 2004 BA-VA could raise rates at the same point in time that they expect to fully realize the merger savings. The merger costs are temporary, but the savings continue indefinitely. Staff supports an eight-year extension of the rate cap, if the merger is approved, as a modest means of capturing some of the cost savings benefits for BA-VA customers.

**Q10. DOES STAFF HAVE ANY OTHER RECOMMENDATIONS CONCERNING THE MERGER COSTS AND SAVINGS?**

**A10.** Yes, it does. Staff recommends that the Joint Petitioners be directed to track the costs and savings of the merger for BA-VA and GTE South. This is necessary for the following reasons. First, under the current alternative regulatory plans GTE South is earnings regulated while BA-VA is price index regulated. GTE South has stated that it will commit to amortize the costs over three years in its annual informational filing. Staff believes that, instead of amortizing the costs for a specific period of time, GTE South should match the actual merger costs with the actual merger savings. If the Commission decides GTE South should amortize the merger costs or match the costs with the savings, Staff will need the actual merger costs and savings information.

Second, because the two Virginia operating companies are regulated on different bases, there may be an incentive to shift the costs to GTE South but keep the savings on BA-VA's books. Staff believes that it will need the actual cost and

savings information from the parent, Bell Atlantic, and both BA-VA and GTE South to assure the Commission that this is not occurring. The review of actual merger costs and savings could be handled during GTE South's annual AIF audit.

The third reason why BA-VA and GTE South should be required to track the costs and savings of the merger is if the Commission decides to review the current alternative regulatory plans. The information would be necessary to ensure that the post merger alternative regulatory plans are in compliance with Virginia Code §56-235.5.

A final reason why the Joint Petitioners should be directed to track merger costs and savings concerns the lack of detail on the best practices planned at this time, as discussed by Staff witness Cummings. By tracking the costs/savings, and thereby determining the source of the merger costs and savings, the Commission would have more assurance that the best practices adopted post merger are not detrimental to the rates and service quality of BA-VA and GTE South.

**Q11. PLEASE SUMMARIZE THE POSITIONS IN YOUR TESTIMONY.**

**A11.** Staff believes that if the Commission approves the merger a complete review of the current alternative regulatory plans of BA-VA and GTE South is necessary. The current plans will not accommodate the effects of the merger. Also, BA-VA and GTE South should be directed to track their actual merger costs and savings. Staff believes that it is more appropriate to have a full review of the current alternative regulatory plans, however, if the Commission decides to extend the cap on BA-VA's basic local exchange rates, Staff supports an eight-year extension of the cap.

**Q12. DOES THIS CONCLUDE YOUR TESTIMONY?**

**A12.** Yes.

**PRE-FILED TESTIMONY  
OF  
FARRIS M. MADDOX**

**BELL ATLANTIC CORPORATION  
AND  
GTE CORPORATION  
PUC990100**

**Q1. PLEASE STATE YOUR NAME AND POSITION AT THE  
COMMISSION.**

**A1.** My name is Farris M. Maddox. I am a Principal Financial Analyst in the Commission's Division of Economics and Finance.

**Q2. WHAT ASPECTS OF THE PROPOSED MERGER DOES YOUR  
TESTIMONY ADDRESS?**

**A2.** My testimony addresses some of the financial aspects of the proposed merger between Bell Atlantic Corporation ("Bell Atlantic") and GTE Corporation ("GTE") (referenced together as "Joint Petitioners") as they relate to Bell Atlantic-Virginia ("BA-VA") and GTE South Incorporated ("GTE South"). The primary focus of my testimony concerns the cross-subsidization threat posed by the Joint Petitioners' stated purpose to continue operating GTE South and BA-VA as separate entities under their fundamentally different plans of alternative regulation. In addition, my testimony also reviews the merger-related savings as projected and allocated in the Joint Petitioners' application.

**Q3. ARE YOU FAMILIAR WITH THE JOINT PETITIONERS' PRIOR  
MERGER APPLICATION IN CASE NO. PUA980031?**

**A3.** Yes. I reviewed that application and was responsible for the Financial Analysis portion of the Staff Report in that case.

**Q4. WHAT WAS THE PRIMARY CONCLUSION OF YOUR ANALYSIS IN CASE NO. PUA980031?**

**A4.** The focal point of my analysis centered on the Joint Petitioners' intentions to continue having BA-VA and GTE South operate separately under two fundamentally different regulatory plans after the proposed merger. As I noted then, bond rating analysts at Moody's Investors Service have voiced concern with the weakening trend in the credit quality of telephone operating companies related to the cross-subsidization threat posed by industry trends of consolidation and increasing diversification into more competitive, unregulated operations. With respect to Virginia, the threat of cross-subsidization would be exacerbated by the proposed merger if GTE South continued to operate under its rate of return (cost of service) regulatory plan while BA-VA continued to operate under its price index plan. This disjointed regulatory structure for the merged companies would provide the opportunity and incentive to shift costs to GTE South and thereby support a rate increase or avoid a refund of earnings that might otherwise be above the authorized range. In combination with the anti-competitive aspects of the merger addressed by Staff witness Sedgley, the cost-shifting threat created by the different regulatory plans could impair or jeopardize adequate service at just and reasonable rates.

**Q5. DID STAFF PROPOSE CONDITIONS IN THE FIRST MERGER CASE THAT WOULD BE SUFFICIENT TO WARRANT ITS APPROVAL?**

**A5.** No. Staff reported that the Joint Petitioners' application did not contain sufficient information to meet their burden of proof that the proposed

merger would not impair or jeopardize adequate service to the public at just and reasonable rates. However, if the Commission were inclined to approve the merger, Staff outlined a number of conditions in that case to help mitigate the anti-competitive, cross-subsidization impacts of the proposed merger.

The Commission concurred with Staff regarding the lack of sufficient information in the Joint Petitioners' application to render an informed decision. The Joint Petitioners' request for authority to merge was dismissed by the Commission without prejudice to refile. However, the Commission directed the Joint Petitioners to provide, at a minimum, certain information in any subsequent merger application which included the jurisdictional level of expected savings and cost attributable to the merger for both BA-VA and GTE South.

**Q6. HAVE YOU REVIEWED THE JOINT PETITIONERS' TESTIMONY REGARDING THE ESTIMATED NET MERGER SAVINGS AND THEIR JURISDICTIONAL ALLOCATION?**

**A6.** Yes.

**Q7. DO YOU HAVE ANY COMMENTS CONCERNING THOSE ESTIMATES?**

**A7.** Yes. As noted earlier, the proposed merger would give the Joint Petitioners the means and incentive to shift costs to rate of return regulated operations and away from operations where earnings are not regulated. The Joint Petitioners' allocation of the savings estimates and the extent of the Joint Petitioners' commitments combine to intensify and support Staff's cross subsidization concerns .

The testimony of Joint Petitioners' witnesses Shuell, Shore, and Hall ("SSH Testimony") describes the merger savings estimation/allocation process from a top-down aggregate level to a Virginia intrastate regulated level. At the aggregate level, it is interesting to note that the allocation of merger savings from the combined expense and capital synergies is 62% ILEC operations and 38% non-ILEC operations. However, the allocation of implementation costs is proportionally higher for ILEC operations at 75% versus 25% non-ILEC operations. It is also interesting to note that the implementation cost as a percent of savings is above 80% for ILEC operations but only 24% for long-distance and Internet operations, two key unregulated components of the merger strategy for bundled service offerings (SSH Schedule A.3).

Based on the next level of the Joint Petitioners' allocation, Bell Atlantic is allocated approximately 68% of the savings and 66% of the implementation costs with GTE receiving approximately 32% of the savings and 33.5% of the implementation costs. The most glaring difference, however, is reflected in merger transaction costs which are estimated to be \$159.5 million for Bell Atlantic and approximately 35% higher for GTE at \$215.5 million. The Joint Petitioners define transaction costs as those incurred to consummate the merger as reflected in SSH Schedule A.2. For Bell Atlantic and GTE, the largest component of these costs is executive compensation agreements, which amount to \$72.5 million for Bell Atlantic and almost double that amount for GTE at \$133.5 million. By the end of the Joint Petitioners' allocation process to the jurisdictional level, BA-VA's cumulative three-year cost estimates reflect 41.7% of its cumulative three-year savings estimates versus 61.4% for GTE.

At face value, the numerical results of the Joint Petitioners' allocations appear to confirm Staff's concerns about shifting costs to operations that are less competitive and/or subject to rate of return regulation. As previously stated, however, the type of commitments offered by the Joint Petitioners also contribute to Staff's cross-subsidization concerns.

**Q8. PLEASE EXPLAIN FURTHER HOW THE TYPE OF COMMITMENTS CONTRIBUTE TO STAFF'S CROSS-SUBSIDIZATION CONCERNS.**

**A8.** The Joint Petitioners' testimony represents that the total Virginia jurisdictional portion of the projected \$2.5 billion merger savings amounts to \$43.1 million net of merger costs by three years after the merger. Of those net savings, the Joint Petitioners calculate that BA-VA's portion amounts to \$36.8 million, while GTE South's portion amounts to \$6.3 million. Despite this wide disparity in the expected level of merger related savings, the Staff views Joint Petitioners' most significant and immediate commitment as GTE South's proposed rate reduction of \$2 million. Considering the unquantifiable value of the other commitments as noted by other Staff witnesses, it would appear that the Joint Petitioners intend to retain and direct the bulk of jurisdictional merger savings to develop and offer competitive and bundled services, as emphasized in the joint petition, testimony and exhibits filed in this case.

Staff's concern regarding the threat of cross subsidization is echoed by Moody's Investors Service ("Moody's"). In an October 6, 1998 press release, Moody's announced downgrades on the debt ratings of BA-VA, Bell Atlantic-New Jersey ("BA-NJ"), Inc., Bell Atlantic-Delaware, Inc.



("BA-DE"), and Bell Atlantic-Pennsylvania ("BA-PA") and indicated they would be kept under review for possible further downgrade as a result of the proposed merger between Bell Atlantic and GTE. In explaining the rationale for the narrowing ratings gap between parent and operating telecommunications companies in general, Moody's stated:

The narrower ratings gap results from the increasing diversification by the parent company into new "strategic" areas of business development, including wireless telephony, data, cable TV, as well as developmental stage telecommunications opportunities.

Like diversification efforts of the past, which were oriented primarily toward non-strategic, financial investments, today's investments possess higher risk characteristics and are often highly leveraged. These factors combine to pressure the credit risk profile of the consolidated entity.

However, unlike the past, today's investments are often viewed as essential services by companies positioning themselves as total communications providers. This assessment makes it increasingly likely that they would not walk away in a time of stress and make it more likely that the parent would tap the telephone operating subsidiaries for financial support.

Even if one accepts the argument that Virginia consumers want and would benefit from the competitive and bundled services that Joint Petitioners seek to offer, it raises questions as to which Virginia consumers and when. A market analysts report, dated December 24, 1998, by Fahnestock & Company noted:

Unlike the forthright, even ambitious National Local Strategy SBC Communications... and Ameritech Corp...detailed when they announced their merger, Bell Atlantic and GTE identified only Chicago, Miami, San Francisco and Los Angeles as cities into which the companies might expand a residential service package.

A related concern is that the Joint Petitioners' focus on establishing a "larger footprint" and developing competitive services is not pursued to the detriment of adequate local service in Virginia at just and reasonable rates. For example, the Joint Petitioners' commitment to maintain the same Virginia specific level of investment through 2002 as it averaged from 1996 through 1998 does not address how such investment will be deployed. The investment could be primarily directed to support the provision of nonjurisdictional, competitive, and/or unregulated services. This strategy would seem consistent with the Joint Petitioners' aim to be a one stop provider of national telecommunications services. Such a strategy, however, could be exercised to the detriment of adequate service for basic telephone services. Staff witness Wickham addresses some of the service quality issues that already exist prior to the proposed merger.

**Q9. DOES BA-VA'S COMMITMENT TO EXTEND THE CAP ON RATE INCREASES FOR BASIC SERVICES FOR THREE YEARS HELP MITIGATE STAFF'S CROSS SUBSIDIZATION CONCERNS?**

**A9.** It is a step in the right direction, but it does not go the distance. Under its price index regulatory plan, BA-VA can initiate annual rate increases for basic service beginning on January 2001, up to one-half of the prior year's increase in the Gross Domestic Product Price Index, regardless of its earnings. After the three year period when merger costs are projected to end, the Joint Petitioners project BA-VA's jurisdictional portion of merger savings to be \$41.6 million per year. The Joint Petitioners' commitment would seem to end around the time when the full extent of the projected merger savings begin to accrue. These savings will keep flowing to a

company whose earnings supported an average return on year-end equity of 28.6% from 1996 through 1998, based on total company operations reported in its December 31, 1998, SEC 10-K filing. Unlike the potential for refunds under GTE South's regulatory plan, there is no assurance that BA-VA's customers will receive any of projected merger savings to accrue to BA-VA. While a rate cap would not flow merger savings through to customers in the form of reduced rates or refunds, it would limit Joint Petitioners' ability to subsidize competitive services by raising BA-VA basic rates (discretionary service rates could still be increased) while the merger savings are being realized.

The Staff and Joint Petitioners disagree as to an appropriate time period for a rate cap commitment. Staff witness Sedgley suggests a longer rate cap period of 8 years is more suitable to help alleviate the anti-competitive aspects of the proposed merger. However, a complete review of the regulatory plans of BA-VA and GTE South is appropriate as it can address other concerns raised by the Staff. Considering the level of BA-VA's earnings, projected merger savings, and the anti-competitive aspects of the proposed merger, the three year rate cap extension appears to be a commitment more of form rather than substance.

**Q10. DO YOU HAVE ANY COMMENTS REGARDING THE JOINT PETITIONERS' CLAIM THAT THE MERGER WILL RESULT IN A LARGER, MORE EFFICIENT COMPANY WITH INCREASED FINANCIAL STRENGTH?<sup>13</sup>**

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<sup>13</sup> Paragraph 50 of the Joint Petition

**A10.** Yes. While I agree that the merged entity will be larger and may achieve some efficiencies due to the merger, I disagree with the Joint Petitioners' claim that it will result in a company with increased financial strength. Through the proposed merger, the Joint Petitioners intend to reposition their combined operations to a more competitive posture. This has already prompted the downgrade of debt ratings for BA-VA, BA-NJ, BA-DE, and BA-PA and placed the debt ratings of Bell Atlantic and its other subsidiaries on alert for possible downgrade related to the proposed merger. The Joint Petitioners' claim appears to be directed to the status of the parent company.

However, the more critical aspect of the proposed merger is the impact it would have on the financial strength and condition of BA-VA and GTE South and their ability to attract capital to provide adequate service at just and reasonable rates. With respect to BA-VA or GTE South, Joint Petitioners do not intend to merge their operations, which might produce direct efficiencies. The savings that are projected to accrue to BA-VA and GTE South primarily arise from savings at the service company/parent company level. The flow-through of such savings depends to a great extent on allocations by affiliates. This reliance on affiliate allocations raises some concerns as to how much of any savings from efficiency gains will flow through to GTE South, BA-VA, and their respective customers. The proposed merger has drawn the debt ratings outlook of GTE South and BA-VA closer together with positive implications for GTE South's weaker credit quality and negative implications for BA-VA's stronger credit quality.

As previously noted, the primary focus of the proposed merger seems to be driven by the prospects for developing and offering a full

array of more competitive telecommunications services. This focus raises Staff's concern about cross-subsidization of these competitive services by basic services and the threat it could pose to the long-term financial strength of GTE South and BA-VA.

**Q11. WOULD CONDITIONS OR COMMITMENTS OTHER THAN THOSE PROPOSED BY JOINT PETITIONERS BE NEEDED TO ADDRESS CROSS-SUBSIDIZATION CONCERNS IF THE MERGER WERE APPROVED?**

**A11.** Yes. The closer scrutiny of affiliate transactions recommended and discussed by Staff witness Dalton would be necessary due to the difference in GTE South's and BA-VA's regulatory plans and the extent of affiliate allocations for the recognition of merger related savings.

**Q12. DOES THIS CONCLUDE YOUR TESTIMONY?**

**A12.** Yes.

**PRE-FILED TESTIMONY  
OF  
PENNY L. SEDGLEY**

**BELL ATLANTIC CORPORATION  
AND  
GTE CORPORATION  
CASE NO. PUC990100**

**Q1. PLEASE STATE YOUR NAME AND POSITION WITH THE COMMISSION STAFF.**

**A1.** Penny L. Sedgley, I work for the Division of Economics and Finance as a Principal Research Analyst.

**Q2. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

**A2.** I will address the issue of the potential effect on local exchange competition in Virginia from a merger between Bell Atlantic Corporation (“Bell Atlantic”) and GTE Corporation (“GTE”), (collectively referred to as “Joint Petitioners”), the parent companies of Bell Atlantic Virginia, Inc. (“BA-VA”), and GTE South, Incorporated (“GTE South”).

**Q3. PLEASE EXPLAIN WHY POTENTIAL COMPETITIVE EFFECTS OF THE MERGER BETWEEN BELL ATLANTIC AND GTE SHOULD BE CONSIDERED IN TERMS OF THE COMMISSION’S CHAPTER 5 AUTHORITY IN VIRGINIA.**

**A3.** Section 56-90 of the Code of Virginia states that the Commission “shall be satisfied that adequate service to the public at just and reasonable rates will not be impaired or jeopardized by granting the prayer of the petition.” While this section of the Virginia Code was written prior to enactment of § 56-265.4:4 C (i-iii),

which is the legislation that opened the local exchange market to competition in Virginia, § 56-90 is nonetheless affected by this subsequent legislation.

Paragraph C 3 (i) of § 56-265.4:4 of the Virginia Code states that the Commission “shall promulgate rules necessary to ... promote and seek to assure the provision of competitive services to all classes of customers throughout all geographic areas of the Commonwealth by a variety of service providers.” Together with The Telecommunications Act of 1996<sup>14</sup> (“The Act”), § 56-265.4:4 of the Va. Code envisions a competitive local exchange telecommunications market. The competitive market should ultimately replace traditional forms of regulation that were used over the years to govern monopoly rates as a substitute for the competitive marketplace. In the future competition must act to assure that adequate service is maintained and that rates remain just and reasonable.

**Q4. WHAT IS STAFF’S POSITION REGARDING THE POTENTIAL COMPETITIVE EFFECT OF THE MERGER BETWEEN BELL ATLANTIC AND GTE IN VIRGINIA?**

- A4.** The merger is anti-competitive in Virginia for the simple reason that common ownership of the two largest incumbent local exchange carriers (“ILECs”) in Virginia will preclude facilities-based competition between those incumbent territories, the type of competition that is expected to promote services and constrain rates, even lower rates in the future.

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<sup>14</sup> The Preamble to the Act: “An Act to promote competition and reduce regulation in order to secure lower prices and higher quality services for American telecommunications consumers and encourage the rapid deployment of new telecommunications technologies.”

As of December 31, 1998, BA-VA served 76% of all access lines in Virginia. GTE South, the second largest ILEC in Virginia, served 13% of the access lines. Combined, these companies would serve 89% of the access lines in Virginia, 88% of all residential lines and 93% of all business lines.<sup>15</sup>

**Q5. PLEASE CONTRAST THE MERGER IN VIRGINIA VERSUS THE MERGER AT THE NATIONAL LEVEL.**

**A5.** This is a merger between Bell Atlantic and GTE. This is a national, even an international, merger between two huge corporations that happen to own incumbent local telephone companies in Virginia.<sup>16</sup> Joint Petitioners and their many witnesses argue that this merger is pro-competitive; perhaps it is at a national or an international level. The negotiations and planning that occurred at the corporate level to enable this merger proposal did not specifically consider any one state, not Virginia or any other state. The merger is about their overall strategy; it is not about Virginia. However, the potential anti-competitive effects of this merger may harm the Virginia local telephone market.

**Q6. ARE YOU SAYING THAT THERE IS NO LOCAL COMPETITION IN VIRGINIA AT THIS TIME?**

**A6.** No, competition for local exchange services in Virginia is increasing. However, we know that the vast majority of residential and business customers have no competitive alternative to the ILEC. Based upon Staff's most recent estimate of competitors providing local exchange service in Virginia, BA-VA still has 98% of its market in its territory, and GTE South has 99% of its market.

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<sup>15</sup> Access lines based upon pamphlet prepared by Virginia Telecommunications Industry Association, Virginia Incumbent Exchange Carriers Network Access Line and Exchange Data, (1999) at 2.

<sup>16</sup> Pennsylvania is the only other state in which both Bell Atlantic and GTE now operate.



Staff does not presently calculate a market concentration ratio, such as the Herfindahl Hershman Index (“HHI”), as it did for the Virginia interexchange market for many years.<sup>17</sup> The HHI is unaffected by small market shares, such as those presently held by certificated local exchange carriers (“CLECs”) in Virginia.

**Q7. WHAT ABOUT COMPETITION FROM THE MANY COMPETITIVE CLECS THAT HAVE BEEN CERTIFICATED IN VIRGINIA?**

**A7.** Not all CLECs are created equal. Not all competitors in this market have the same ability to compete for customers, the same ability to build facilities, the same ability to bundle services, nor the same ability to influence the direction of the competitive market. Bell Atlantic and GTE argue that they must merge in order to attain sufficient scale and scope to compete effectively. Mr. Stallard’s testimony, at page 29, states that only AT&T and MCI/WorldCom have the scale and scope to compete successfully. This supports my premise that not all CLECs are created equal.

It is the competitive threat from the large facilities-based carriers that appears to be the major influence on the growth of competition at the local level at this time. The Joint Petitioners’ filing for approval of its merger at the Federal Communications Commission (“FCC”) states at page two of the Public Interest Statement that the merged company will have a far greater ability to enter and compete quickly and effectively against other incumbent Bell companies. Further, at page seven, Joint Petitioners state that economical entry requires truly proximate facilities. According to the Joint Petitioners, even the FCC has

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<sup>17</sup> The HHI is calculated by summing the squared market share of all market participants. Market shares as low as 1% (.01) or less, when squared (.01x.01=. 0001), will have no effect on the index when added to the squared market shares of the incumbents, until 50 or more participants have market shares of at least 1%.

concluded in several orders recently that the ILECs may represent the most potent competitors against one another, particularly where territories are contiguous.<sup>18</sup>

We can observe the vigorous consolidation that is occurring with mergers between the already large incumbents, such as Bell Atlantic and GTE, and also between the big companies and the small emerging competitors. SBC first merged with Pacific Telesis and now has a merger pending with Ameritech. MCI and WorldCom merged, while also buying UUNet, Brooks Fiber, and others. AT&T first bought cable company TCI and now has a proposed merger with MediaOne. Bell Atlantic first merged with NYNEX, now it proposes a merger with GTE. These are merely the most high profile consolidations.

There are many mergers and buy-outs occurring with smaller competitors, both long distance and local, Internet, and data transmission. These consolidations are occurring to gain access to existing and potential customers, to extend holdings to existing territories with facilities, and to put together a bundle of services that the resulting company can offer as a “one stop” shopping convenience. Indeed, this is what Joint Petitioners have proposed at the FCC, the need to acquire the existing service territories of GTE for Bell Atlantic to compete with other Bell companies, the need to acquire GTE’s existing Internet backbone, and then to bundle all services to offer a full package of services.

Absent the merger between Bell Atlantic and GTE and based upon the market trend toward consolidation, it appears a good possibility that GTE would itself buy or merge with another carrier, either large or small. This then would position that combined company as an even more potent threat to BA-VA, thus significantly advancing competition within Virginia. While combined companies such as AT&T/TCI/MediaOne, MCI/WorldCom, and others certainly are

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<sup>18</sup> In the Matter of GTE Corporation, Transferor, and Bell Atlantic Corporation, Transferee, for Consent to Transfer of Control, CC Docket No. 98-184, October 2, 1998, Public Interest Statement, at 1.

potential competitors, they simply don't have the local market power that an ILEC has. This is particularly true for an ILEC that has already merged or bought other companies to combine services and territories, making use of the efficiencies of scale and scope that they say will come about through these mergers. Such an entity begins competing from a position of strength: substantial market share, substantial financial resources, substantial facilities, and substantial managerial and technical expertise.

Resellers do not represent effective competition as their pricing is constrained by the price they pay to the ILEC and by the services that the ILEC agrees to provide. Effective competition will come from facilities-based carriers that can price services based upon their own costs and based upon their own efficiencies of scale and scope.

**Q8. WHAT ABOUT POTENTIAL COMPETITION BETWEEN BA-VA AND GTE SOUTH IN VIRGINIA?**

**A8.** The fact that much of GTE South's territory in Virginia is contiguous to BA-VA's territory is one reason that Staff considers GTE a significant potential competitor to BA-VA. In fact, GTE Communications Corporation ("GTECC"), a subsidiary of GTE, filed for CLEC authority in Virginia (Case No. PUC980080), prior to the time that the merger between Bell Atlantic and GTE was announced. As a part of discovery in that proceeding, GTECC listed BA-VA exchanges that it planned to enter upon receiving its CLEC authority. GTECC withdrew its request and the Commission granted the withdrawal on October 9, 1998, just after the merger petition was filed on October 2, 1998.

Discovery conducted as a part of the initial merger application of Bell Atlantic and GTE (Case No. PUA980031) revealed that Bell Atlantic had initially anticipated out-of-franchise entry into GTE's territory; however, Bell Atlantic's

more recent plans have backed away from out-of franchise entry. In response to Staff inquiries in that case, BA-VA indicated that it did not project GTE South's territories in Virginia as attractive for its own potential competitive entry. Regardless of Bell Atlantic's or GTE's specific plans for competitive entry as of one year ago or as of several years ago, there will never be any competition between these incumbent facilities-based providers if the same company owns both territories in Virginia.

**Q9. ARE YOU SAYING THAT COMMON OWNERSHIP OF BA-VA AND GTE SOUTH WILL PERMANENTLY PRECLUDE COMPETITION IN VIRGINIA?**

**A9.** No, however I believe that it will significantly delay effective competition in the local exchange market in Virginia. Ultimately, as AT&T, MCI/WorldCom, and other large facilities-based competitors gain market share, as smaller competitors gain market share, and as new technologies for providing services are perfected, common ownership of BA-VA and GTE South may have less significance. However, the period of time that will be necessary for this competition to take hold is uncertain. The lack of effective competition in the near future precludes a reasonable assurance that adequate service at just and reasonable rates will not be jeopardized or impaired, particularly when the cap on BA-VA's basic rates expires as of January 1, 2001.

**Q10. CAN STAFF'S ANTI-COMPETITIVE CONCERNS ABOUT THE MERGER IN VIRGINIA BE ACCOMMODATED WITHIN THE CURRENT ALTERNATIVE REGULATORY PLANS ("PLANS") FOR BOTH BA-VA AND GTE SOUTH?**

**A10.** Staff has concerns over the ability of BA-VA and GTE South, under common ownership, to move forward under their current Plans. These Plans were crafted and put into effect prior to market opening legislation in Virginia, prior to the Act, prior to the bundling of services that Joint Petitioners propose, and with no thought to common ownership of the two companies. For example, the two Virginia ILECs that now share common ownership, Centel and United-SE of Virginia, both operate under the same alternative regulatory plan. The current Plans have no effective means to deal with the service quality issues discussed by Mr. Wickham. The current Plans cannot accommodate the potential for cross-subsidization that is discussed by Ms. Gilmour and Mr. Maddox.

**Q11. ARE THERE STEPS THAT COULD BE TAKEN THAT WOULD ALLEVIATE THE POTENTIAL ANTI-COMPETITIVE EFFECTS OF THE MERGER IN VIRGINIA?**

**A11.** Yes. There are essentially two results from the anti-competitive effects of the merger in Virginia. First, is the potential effect on rates and services. Staff has identified that the Plans, as presently crafted, will not accommodate the merger for the many reasons mentioned above. A complete re-evaluation of the Plans is needed to assure that adequate service at just and reasonable rates will be protected in the future.

Second, there is the potential effect on actual competition in Virginia, from the merger. Measures are needed that will serve to make the market more competitive in order to comply with § 56-265.4:4 of the Va. Code, as discussed earlier. These measures could include market opening conditions. Ms. Cummings addresses these measures more specifically.

**Q12. PLEASE ADDRESS THE 3-YEAR EXTENSION OF THE CAP ON BASIC RATES PROPOSED BY BA-VA.**

**A12.** Mr. Stallard's testimony at page 3 pledges to extend the cap on basic rates until January 1, 2004, and at page 17 Mr. Stallard states that after 2004, the GDP-PI provision of BA-VA's alternative regulatory plan will govern price increases,<sup>19</sup> so that rates will remain affordable in the future. However, the Companies project that full savings from the merger will take effect after 3 years; therefore a 3-year extension of the cap will encompass only that time until full savings are expected to occur. Under this scenario it is unlikely that customers would receive any benefit from actual savings. Ms. Gilmour also discusses the issue of savings.

In order to alleviate concerns regarding the potential negative effect on rates, in Case No. PUA980031 Staff proposed an 8-year extension of the basic rate cap in BA-VA's alternative regulatory plan. An extension of the freeze on basic rates would provide assurance that the merger would not impair or jeopardize those rates, not only to BA-VA's retail customers, but also its wholesale customers, the CLECs.<sup>20</sup>

**Q13. PLEASE EXPLAIN WHY STAFF'S ANALYSIS IN THIS CASE IS MORE EXTENSIVE THAN, FOR EXAMPLE, THE MCI/WORLDCOM MERGER, CASE NO. PUA970052.**

**A13.** Prior to their merger, the Virginia Commission never traditionally regulated MCI or WorldCom. Neither company has a monopoly over any service under the jurisdiction of the Virginia Commission. Although both MCI and WorldCom hold CLEC certificates in Virginia, their rates for these services are capped by the

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<sup>19</sup> Bell-Atlantic-Virginia Plan for Alternative Regulation, at ¶ 6 B 2, states that after the year 2001 any individual price increase (for basic services) shall not exceed ½ the increase in the Gross Domestic Product Price Index (as defined in ¶ 10) for the preceding year.

<sup>20</sup> An extended cap on basic rates, however, does not allow for lower rates that might have come about through more effective competition.

rates charged by the incumbent. Therefore, it is Staff's belief that its analysis of a merger under those circumstances need not encompass the breadth of issues in the instant case. However, I believe that each application must be evaluated individually and the scope of issues may differ.

A potential merger between two companies whose basic rates are still regulated differently through each company's alternative regulatory plan and for which the vast majority of customers have no alternative for the provision of local service, requires additional analysis to assure that service remains adequate and that rates will remain just and reasonable in the future. Staff's analysis must be tailored to the method of regulation for the carriers involved, an issue addressed more extensively by Ms. Cummings.

**Q14. WHAT RELEVANCE DOES THE DEPARTMENT OF JUSTICE ("DOJ") REVIEW OF THE BELL ATLANTIC/GTE MERGER HAVE FOR THE VIRGINIA LOCAL MARKET?**

**A14.** Joint Petitioners have relied upon the DOJ review as evidence that the merger is not anti-competitive. However, the testimony of Joint Petitioners' witnesses Gould/Gertner<sup>21</sup> states only that it is "highly likely" that the DOJ review included the provision of local exchange service in Virginia. Nowhere in the public documents available from DOJ (the Competitive Impact Statement, the Stipulation and Proposed Final Judgement, or the Complaint) is there any reference by the DOJ to specific analysis of the local market in Virginia.

In fact, the Complaint, at page three, paragraph eight, addresses interstate commerce as the subject matter over which the Court has jurisdiction. I have seen no evidence that the DOJ review addressed the Virginia local market. The DOJ is

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<sup>21</sup> Joint Petition of Bell Atlantic Corporation and GTE Corporation, For approval of agreement and plan of merger, PUC990100, Testimony of John P. Gould and Robert H. Gertner, at 8.

certainly aware that the individual states will address local competition, as will the FCC under its public interest standard. Regardless, approval of a transaction by one entity (in this case the DOJ) does not preclude a separate challenge by any other regulatory entity (state or federal), nor does it preclude additional or different conditions to resolve concerns of these entities, such as the FCC or the Virginia Commission.

**Q15. JOINT PETITIONERS' WITNESSES GERTNER/GOULD CHARACTERIZE THE ELIMINATION OF ONE POTENTIAL COMPETITOR AS INCONSEQUENTIAL. PLEASE COMMENT ON THIS.**

**A15.** Staff's concern is not just the elimination of specifically GTE South or BA-VA as potential competitors; it is the elimination of a potential facilities-based competitor with existing territories adjacent to, or truly proximate (in the Joint Petitioners' own words) to the potential competitor. Through common ownership of the two ILECs, effective, facilities-based competition between these territories will be delayed even further. This is the crux of the anti-competitive issue in Virginia.

**Q16. GERTNER/GOULD CONTEND THAT MERGING WITH A POTENTIAL COMPETITOR DOES NOT ASSURE THAT PRICES WILL RISE. PLEASE COMMENT ON THIS.**



**A16.** Staff cannot say that prices will definitely rise if this merger occurs in Virginia. It is simply Staff's position that Joint Petitioners have not provided sufficient assurance that there will be no harm to just and reasonable rates and adequate service in Virginia. Without sufficient effective competition to constrain rates in the future, safeguards or conditions may be needed to assure no harm to basic rates and service and to maintain just and reasonable rates in the future.

**Q17. WHAT IS YOUR POSITION REGARDING THE MERGER?**

**A17.** Staff is not satisfied that Joint Petitioners have provided sufficient assurance that adequate service at just and reasonable rates will not be jeopardized or impaired as a result of the merger. Further, Staff believes that competition and competitors themselves may be disadvantaged as a result of the merger.

Bell Atlantic and GTE have not met their burden of proof under § 56-90 of the Virginia Code. However, the Commission could alleviate anti-competitive concerns regarding rates and service through a complete re-evaluation of the Plans for both BA-VA and GTE South. Anti-competitive concerns regarding competition itself could be alleviated through market opening conditions.

However, should the Commission choose not to re-evaluate the Plans, an 8-year extension of the freeze on BA-VA's basic rates would alleviate the anti-competitive threat only with regard to rate levels.

**Q18. DOES THIS CONCLUDE YOUR TESTIMONY?**

**A18.** Yes, it does.